

Credit Union Department

Report on the effects of COVID-19 on industry operations and existing statutory
and regulatory barriers to

the

HOUSE OF REPRESENTATIVES Committee on Pensions, Investments and Financial Services

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Commissioner

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ABOUT THE DEPARTMENT

The Department's mission is to safeguard the public interest, protect the financial interests of credit union members, and promote public confidence in the credit union industry. Through its regulatory and supervisory functions, the Department ensures credit unions, chartered under state law, operate as sound and responsible institutions that enhance the financial well-being of their members.

The policy making body for the Department is the Credit Union Commission. The Commission is a nine-member board of private citizens appointed by the Governor of Texas and is not a separate state agency. Four of the Commission's members must have had at least five years' active experience as an executive, officer, director, or committee member of a credit union. Five of the members are designated as "public members" and may not be employed by or participate in managing or directing any type of financial institution. Current members of the Commission are:

Yusuf E. Farran, Chair	El Paso, Texas
Sherri Brannon Merket, Vice Chair	Midland, Texas
Elizabeth "Liz" Bayless	Austin, Texas
Beckie Stockstill Cobb	Deer Park, Texas
Steven "Steve" Gilman	Katy, Texas
Jim Minge	Arlington, Texas
Karyn C. Brownlee	Coppell, Texas
David F. Shurtz	Hudson Oaks, Texas
Kay Rankin-Swan	Monahans, Texas

The safety and soundness of the credit union industry and its compliance with laws, rules, and regulations is our primary objective. The Department promotes safe and prudent credit union practices through examinations, regular communication with credit union officials, and the review of applications submitted by credit unions to initiate and expand their activities. When appropriate, the Department has a range of informal and formal enforcement options available to resolve regulatory concerns identified at a credit union. The Department also helps ensure that credit union members receive fair and timely resolution of their complaints if they are unable to resolve their issues independently.

The Department supervises credit unions by conducting on-site examinations and by performing ongoing off-site monitoring. These activities help monitor the condition of individual credit unions and the overall stability of the Texas credit union system. The frequency of on-site examinations is determined by the credit union's size, complexity, risk profile, and condition. The on-site examinations are conducted at least every 18 months (more frequently if the credit union is experiencing problems).

SDSI Self-Funding Status

The Department was designated "self-directed and semi-independent" during the 81st Legislative Session. As a result of the SDSI status, the Credit Union Commission is responsible for annually setting the spending authority or limits for the Department and is focused on emphasizing transparency and accountability.

All revenues for operations are derived from assessments paid by Texas chartered credit unions. The assessments are placed in a separate account at the Texas Treasury Safekeeping Trust Company. The Department endeavors to match revenues with expenditures to ensure that credit

unions are not charged more than is required to maintain the agency's operations and meet its statutory mandates. The Department's FY 2020 budget is \$4.5 million, with authorized FTEs of 30.

Accredited Credit Union Regulatory Agency

The Department is accredited by the National Association of State Credit Union Supervisors (NASCUS). The NASCUS accreditation program applies national standards of performance to all functional areas of a state credit union regulatory program. Initially accredited in 1996, the Department is re-accredited by NASCUS every five years through onsite review by peer state and federal regulators. Most recently, it received re-accreditation in 2016. Ongoing annual reviews by NASCUS are conducted to monitor maintenance of accreditation standards. Accreditation provides the Department with national recognition among its peers and professional respect from the institutions it regulates and supervises.

ABOUT THE INDUSTRY

The Department's supervisory authority is exercised over 177 credit unions that control approximately \$48.6 billion in financial assets as of June 30, 2020. The agency also oversees branches of out-of-state credit unions operating in the state.

Credit unions are deposit pools formed by groups of affiliated people. These groups of members own and control the credit union. Credit union membership is limited to restrictions outlined within Texas statutes to groups that share the credit union's community of interest, such as having the same employer, belonging to the same social group, or living in the same city. Credit unions encourage thrift among their members and pool member funds to lend at reasonable terms to other members.

Credit unions typically specialize in consumer lending. Since the late 1970s, credit unions have received authority to engage in a wide range of financial services, including mortgage lending, credit card issuance, share draft accounts, and a certain degree of business lending.

Dual Chartering

You may have seen or heard the term "dual chartering system." This refers to the fact that both federal and state governments issue credit union charters for the convenience of their citizens. The National Credit Union Administration (NCUA) charters federal credit unions; the state credit union department charters state credit unions. "federal" or "state" credit union has nothing to do with where a credit union does business; it refers only to the kind of charter the credit union has. The NCUA, unlike other federal charterers of financial institutions, also provides federal deposit insurance.

The chartering agency is a credit union's primary regulator, with front-line duty to protect the public against unsafe and unsound credit union practices. Charterers conduct on-site examinations to assess credit union condition and monitor compliance with credit union laws. They issue regulations, take enforcement actions, and close credit unions if they fail.

All credit unions were organized under state law from 1913 until 1934, when the Farm Credit Administration began to charter federal credit unions. The NCUA, established in 1970, now charters federal credit unions.

Given these differences, the department only supervises Texas chartered credit unions, which as of June 30, 2020 represented the following statistics.

Number of Institutions	177
Aggregate Assets	\$48.6 Million
Loans Outstanding	\$33.4 Million
Aggregate Deposits Held	\$42.1 Million
Aggregate Net Worth Ratio	10.36%
Aggregate ROAA Ratio	0.52%
Aggregate Delinquency Ratio	0.70%

Effects of COVID-19 on Industry or Business Operations

The Texas chartered credit union (TCCU) industry, as the entire nation, has been significantly impacted by the COVID-19 pandemic through the effects on credit union employees, members and operationally as organizations.

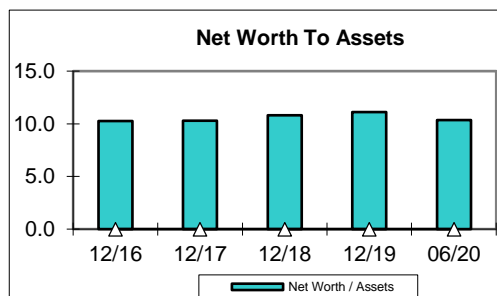
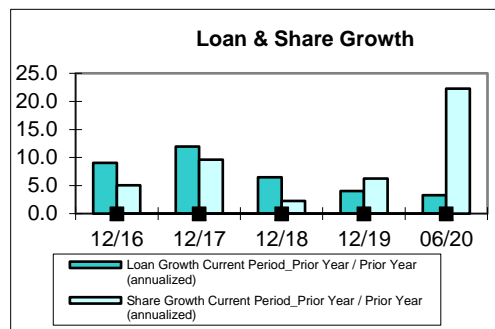
Due to the nature of the pandemic, credit unions shifted operations to safely meet the needs of consumers. Limitations on physical contact have necessitated restricting branch access and, in some cases, full branch closures. TCCUs have continued to provide depositors access to safe financial services through limited branch access, debit cards, ATM networks, drive-thru, internet and mobile applications. With potential exposure of the virus and need for responsiveness, the Department has provided regulatory relief relating to approvals of emergency branch closures and appraisal requirements. Further, the Department has provided significant information directly to credit union chief executives related to financial crimes, cybersecurity concerns, and a host of state and federal regulatory matters with implications to the pandemic.

Lending activities have been significantly impacted by the virus as well as the related overall economic downturn. Limitations on physical access has slowed some lending processes. While credit unions have shifted resources appropriately, certain activities in the home equity/real estate arena require contact through appraisal, title work, document filing, etc. The Department has worked jointly with the Texas Finance Commission agencies to provide guidance across the financial services industries to ensure consistent application to consumers. While these guidelines have been well received, the industry continues efforts to address issues outside of Department jurisdiction relating to home equity loan closures in the pandemic environment and compliance with physical closing provisions of the Texas constitution.

The full credit union economic impact of the pandemic has yet to fully materialize as implications of the CARES Act, other regulatory relief measures, and industry forbearances/deferments during the initial phases of the pandemic have lessened the impact. Charge off and delinquency rates remain steady but are expected to rise unless economic stability improves, or additional relief measures are implemented. Due to the widespread environment of economic uncertainty the industry has also experienced a softening demand for loan products.

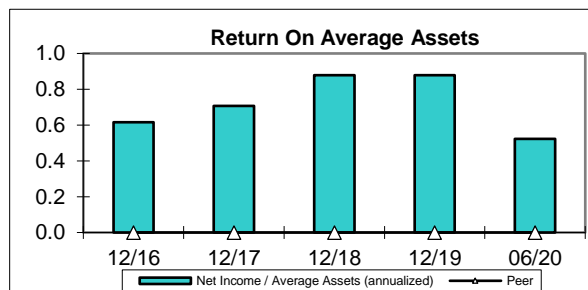
Financially, Texas chartered credit unions (TCCUs) continue to weather the ramifications as management teams appropriately shift resources to address the health implications of operating with limitations to physical interaction and the potential economic impact to membership credit risk.

TCCUs experienced significant (20%) annualized asset growth for the calendar year-to-date ending June 30, 2020 to \$48.6 Billion. This growth was funded by sharp increases in membership deposits. Member savings growth of this type is typical early in economic downturns as part of consumer flight to safety to decrease their own liquidity and credit risk. It appears stimulus funds paid during the 2nd quarter of 2020 also contributed to the rapid deposit growth.



While in aggregate, TCCUs remain well capitalized and with positive earnings, the significant growth of total assets has driven declines in the net worth (NW) and return on average assets (ROAA) ratios.

Despite over 5% growth in net worth dollars, the aggregate NW ratio for TCCUs has declined 75 basis points to 10.36% of total assets during 2020. Aggregate annualized ROAA for TCCUs has also been impacted by the significant increase in total assets falling approximately 36 basis points during 2020, to .52% of total average assets. Additional factors impacting the declines in financial performance trends include significant COVID-19 related pandemic expenses, stressed earnings capacity due to the low interest rate environment and repressed member loan demand due to economic uncertainty. As of June 30, 2020, thirty-nine TCCUs experienced year-to-date operating losses, three broke even and 135 were profitable.



The Department continues to perform its examination function and in March initiated regular informal follow-up contacts to ensure timely updates on the status of each institution chartered by Texas and any potential difficulties the institution is experiencing relative to the pandemic. The Department will continue to utilize its resources to closely monitor the impact of the COVID-19 pandemic and any other factors impacting the credit union industry to meet its mission as defined by the Texas Finance Code and assist, where possible and prudent, the industry to maintain its soundness and viability.